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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972.

No. 72-1740

RICHARD J. SENNOTT AND JOAN SENNOTT,
*Petitioners,*

*vs.*

RODMAN & RENSHAW,
*Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Petitioners Richard J. Sennott and Joan Sennott pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on January 18, 1973.

## OPINIONS BELOW.

The Findings of Fact and Conclusions of Law of the District Court for the Northern District of Illinois are unreported and appear in Appendix A, pp. A1-A10. The opinion of the Court of Appeals is reported at 474 F. 2d 32 (Appendix A, pp. A14-A26, *infra*).

## JURISDICTION.

The judgment of the Court of Appeals was entered on January 18, 1973. Petition for rehearing and suggestion of *en banc* rehearing was denied on March 28, 1973, Judges Stevens and Sprecher dissenting (Appendix A, pp. A27-A28, *infra*). Jurisdiction is conferred on this Court by 28 U. S. C. Section 1254(1).

## QUESTIONS PRESENTED.

1. Whether a securities firm is liable for fraud in the sale of securities perpetrated by its representatives.

2. Whether a securities firm may escape liability as an aider and abetter of the securities fraud committed by its representatives because it did not have actual knowledge of such fraud.

3. Whether a securities firm may escape liability as a controlling person under Section 20(a) of the Securities Exchange Act of 1934 (48 Stat. 899, as amended, 15 U. S. C. § 78t) because (a) it did not have actual knowledge of the securities fraud committed by its representatives and (b) the securities fraud was not for its direct benefit.

## STATUTES INVOLVED.

The pertinent sections of the Securities Act of 1933 (48 Stat. 74, as amended, 15 U. S. C. § 77a-77aa) and the Securities Exchange Act of 1934 (48 Stat. 881, as amended, 15 U. S. C. § 78a-78hh-1) are set forth in Appendix A, pp. A28-A31.

## STATEMENT OF CASE.

Petitioners Richard J. Sennott and his wife Joan Sennott brought this suit against Rodman & Renshaw ("Rodman"), a securities firm, William Rothbart, a Rodman partner, and Jor-

dan Rothbart, the son of William, in the United States District Court for the Northern District of Illinois charging violations of the federal securities laws arising out of a scheme in which Richard J. Sennott and Joan Sennott were defrauded out of $100,000.00 for the purchase of non-existent securities. Jurisdiction of the trial court was based upon the violations of such securities laws (15 U. S. C. §§ 77r and 78aa). Judgment by the trial Court for petitioners for $99,600 plus interest and costs as against Rodman was reversed by the Court of Appeals.

**Background.**

Richard J. Sennott is a member of the Chicago Board of Trade. Respondent Rodman is a broker-dealer in Chicago, Illinois and member of the New York Stock Exchange and the Chicago Board of Trade.

Jordan Rothbart became a member of the Board of Trade in 1960. Prior to that time he had been a securities salesman for Reynolds & Co. and then in 1957 and early 1958 for Rodman. While at Reynolds & Co., Jordan Rothbart defrauded customers and was found by the SEC to have violated the federal securities laws (App. A6-7). For his frauds, his license as a representative of a member of the National Association of Securities Dealers ("NASD") was revoked (App. A6-7). At the time he was victimized Richard Sennott did not know any of this background information nor did anyone at Rodman ever inform him of such facts (App. A5-7).

William Rothbart was a partner with a ten percent interest in Rodman throughout the period relevant to this lawsuit. At trial, Rodman's managing partner described William Rothbart as "one of the least informed on [securities] regulations that we had with our company. . . . I think that he was, by his nature, willing to take more liberties than our firm would permit". This view of William Rothbart by Rodman also was never told to Sennott (App. A5).

The fraud arose from the following facts and circumstances.

Prior to late 1963, Richard Sennott had purchased only six or seven stocks in his life, all at the suggestion of friends (App. A3). In the spring or summer of 1963, Sennott met Jordan Rothbart when Jordan started trading in the soybean oil and meal pit at the Board of Trade. Jordan traded for his own account and filled orders on the floor for Rodman. They became friendly and Sennott recommended trades to Jordan Rothbart in the soybean oil and meal futures market.

In late 1963, Jordan Rothbart, during one of his usual conversations with Sennott about trading at the Board of Trade, told him that his father William had made money for several Board of Trade members in the stock market and that if Sennott ever wanted to open a stock trading account Jordan would be glad to open one for him at Rodman. Sennott told Jordan Rothbart that he had no experience in investing in stocks, but that if Jordan had any recommendations about stock to tell him and he might invest (App. A2). The first one or two times Jordan mentioned trading stocks, Sennott took no action. However, in January, 1964 when Jordan told him that William Rothbart thought a particular stock was a good buy, Sennott told Jordan to buy some for him. Jordan then went to the Rodman telephone on the floor of the Board of Trade (a direct line to its offices), which was very close to the soybean oil and meal pit, and came back a short time thereafter and told Sennott the price at which the stock had been bought through Rodman.

Also in January, 1964 an account was opened by Sennott at Rodman in the name of his wife, Joan Sennott, even though he did not meet anyone connected with Rodman other than Jordan Rothbart until April 1, 1964 (App. A3).

After this account was opened, Sennott began to regularly trade stock through Rodman through his wife's account and the six other accounts he ultimately opened at Rodman. Trad-

ing in the seven Sennott accounts continued from January, 1964 through June, 1966, and totalled over $2,000,000 (App. A16).

Seventy percent of the many trades in the seven accounts opened by Sennott at Rodman were solicited by Jordan Rothbart. Jordan would tell Sennott that his father was "bullish" or "bearish", recommend that Sennott buy or sell a particular stock and Sennott would place a buy or sell order. Jordan then went to the Rodman telephone on the floor of the Board of Trade and reported back a short time later the price at which the transaction had been executed. A day or two later, Sennott received a confirmation slip from Rodman (App. A3, A16).

In addition to Sennott, Jordan Rothbart also solicited the business of at least five other members of the Board of Trade who purchased and sold stock through Rodman but never had contact with anyone but Jordan Rothbart (App. A5-6). In handling his stock trades for Rodman, Jordan Rothbart talked with William and his brother Glen Rothbart, a registered representative of Rodman, three or four times a day on the direct telephone line from the Board of Trade to Rodman. This phone was under the control of a Rodman employee and was only used by three people—a Rodman partner at the Board of Trade, a Rodman broker at the Board of Trade and Jordan Rothbart (App. A6).

In February, 1964, Jordan Rothbart approached Sennott and told him that Skyline Homes, Inc. "was going to be listed on the New York Stock Exchange, and they needed more shares to become eligible, and that they were going to run a secondary offering through Rodman & Renshaw at approximately 40 [dollars] per share". Jordan told Sennott that Skyline had "great earnings" and a "glowing future" and Sennott ordered 2,000 shares. Jordan responded that the offer might be oversubscribed, but "he would do his best" to get Sennott the shares (App. A8).

Subsequent to giving this order but prior to the public offering of Skyline Homes taking place, Jordan Rothbart approached Sennott with respect to the purchase of more Skyline Homes stock, this time through the exercise of stock options. Rothbart told Sennott that a number of options for the purchase of Skyline Homes, Inc. stock had been made available to him, that the options had initially been offered to his father William Rothbart, a partner in Rodman, in return for services his father had rendered Skyline Homes, Inc. in the secondary public offering referred to above and also for helping Skyline Homes, Inc. become listed on the American Stock Exchange, but that, when Rothbart's father turned down the offer because SEC regulations forbid such transactions on the part of broker-dealers, the options had been made available to him. Jordan Rothbart said that he was willing to exercise some of the options on behalf of Sennott. Jordan Rothbart also told Sennott that he was going to exercise some of the options for himself and that all the money for the options would be held in escrow in New York City until the time came for the exercise of the option rights. He told Sennott that the options would be exercised for shares of Skyline Homes, Inc. stock within seven months and that he would then deliver shares of said stock to Sennott at a price of $26.50 per share (App. A3-4).[1]

In fact, no such options as described by Jordan Rothbart were available to him, William Rothbart or Rodman (App. A5).[2]

In reliance upon Jordan Rothbart's false representations, Sennott gave him a check for $25,000 on March 18, 1964. On April 6, 1964 Jordan told Sennott that more options were available and he gave Jordan another check for $25,000.

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1. Skyline Homes, Inc. stock split two for one in September, 1964 and the agreed price for the option shares became $13.25 (App. A4).

2. However, in 1964 it was not unusual for broker-dealers to be paid with options to act as underwriter in a public offering. When Skyline Homes, Inc. first had a public offering in 1960, Rodman was the principal underwriter and received some options.

On April 9, 1964 the public offering of Skyline Homes became effective and Sennott received the 2,000 shares he had ordered from Jordan. Sennott immediately sold 1,000 of the shares he received at a four or five dollar per share profit to get more money to invest in Skyline Homes options and, on April 29, 1964, he gave Jordan another $22,000 for more options to buy shares of Skyline Homes stock.

In addition to the above transactions, Sennott gave Jordan Rothbart an additional $60,000 for Skyline stock between May 21, 1964 and October 2, 1964. On each of these occasions, Jordan told Sennott that more options were available and that he, Jordan, was making out a check and gave Sennott the chance to also invest (App. A4).

All of these option stock deals called for delivery of the shares six to nine months after Sennott turned the money over to Jordan Rothbart. In all Jordan Rothbart contracted to deliver about 9,950 shares of Skyline Homes stock.

The last payment by Sennott to Rothbart was on October 2, 1964, just prior to the time (October 18) when the first deliveries of Skyline Homes stock promised by Jordan Rothbart were due. However, no stock was delivered on October 18 as promised and when Sennott inquired of Jordan he was told that delivery had been delayed because there still weren't enough shareholders to enable Skyline Homes to be listed on the "Big Board".

In November, 1964, Sennott got a telephone call from William Rothbart who told him that Vernon Carroll, the managing partner of Rodman, had some questions relating to some checks and would like to meet with him. Sennott agreed to a meeting that afternoon. When he arrived at Rodman's offices for the meeting, William Rothbart met Sennott at the door and "told me that it was really none of Mr. Carroll's business, that not to worry, I would get my stock options" (App. A4). At the meeting, also attended by Jordan and William Rothbart, Carroll

inquired why certain checks drawn by Rodman and delivered to Sennott had ended up in Jordan Rothbart's wife's bank account. Sennott, following the instructions of William Rothbart, refused to answer Carroll's questions (App. A4-5). Jordan and William Rothbart also did not respond. At this meeting Carroll did not tell Sennott about Jordan Rothbart's background, the known laxity of William Rothbart toward securities regulations or that Jordan Rothbart was, in fact, neither a partner nor registered representative of Rodman. Sennott knew none of these things at the time of the meeting (App. A5).

Between February, 1965 and January 20, 1966, Rothbart from time to time actually delivered a total of 2,200 shares of Skyline stock to Sennott. During this whole period, Jordan kept making excuses for his delays in delivery, *e.g.*, that there weren't enough shareholders for Skyline to be listed on the New York Stock Exchange (App. A5). The deliveries that were made constituted deception designed to forestall further inquiry by Sennott (App. A19).

**Proceedings in the Trial Court.**

Upon discovery of the fraud, suit was filed. After a three day trial, the trial court awarded Sennott and his wife judgment against Rodman, William Rothbart and Jordan Rothbart in the amount of $99,600.00 together with interest and costs.[3] Each defendant was found to have violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 adopted by the Securities and Exchange Commission ("SEC"). In addition, defendant Rodman was found to have aided and abetted defendants Jordan Rothbart and William Rothbart in their violations of the federal securities law and to have failed to perform its duty under Section 20(a) of the Securities Exchange Act of 1934 to act in good faith in exercising its control over William and Jordan Rothbart.

3. Rodman & Renshaw was awarded judgment for the same amount on its claim over against Jordan Rothbart and William Rothbart.

The district court found that Jordan Rothbart made false representations to Richard Sennott in order to induce Sennott to give him $132,000 for the purchase of securities under a non-existent option plan (App. A4). The district court also found that Jordan solicited orders for the purchase and sale of many other securities by Richard Sennott which orders were executed through Rodman by William Rothbart or his son, Glen Rothbart, a registered representative of Rodman (App. A3). Indeed, in order to protect this profitable business for himself and Rodman, the district court found that William Rothbart represented to Richard Sennott that the stock promised him by Jordan Rothbart would be delivered (App. A4).

The district court also found that Rodman through at least one of its partners, William Rothbart, knew that Jordan Rothbart was soliciting stock orders from Richard Sennott and others at the Board of Trade and, in violation of its duties as a broker-dealer, allowed Jordan to continue to solicit such stock orders knowing that this was in violation of the federal securities laws (App. A6).

The district court further found that Rodman failed to inform Richard Sennott (1) that the SEC had found Jordan Rothbart guilty of defrauding customers while acting as a registered representative for another brokerage house, (2) that Jordan Rothbart was not in fact a partner or registered representative of Rodman and (3) that William Rothbart was known by Rodman to be lax in his obedience of the federal securities laws (App. A6-7).

The district court held that Rodman breached its obligations as a broker-dealer by placing Jordan Rothbart in a position where he was able to perpetrate the fraud involved in this case *and* by failing to properly supervise William and Jordan Rothbart (App. A6, A8). Only Rodman appealed.

**The Decision of the Court of Appeals.**

The Court of Appeals for the Seventh Circuit reversed holding that William Rothbart did not have knowledge of the stock option deception of Jordan Rothbart "at any pertinent time" and, absent such knowledge, Rodman could not be held liable. In addition, the Court of Appeals stated that Rodman was not liable because Sennott did not rely in the fraudulent transactions upon Jordan Rothbart's apparent authority to act as representative of Rodman. The Court of Appeals did concede that Jordan Rothbart had been soliciting stock business from Sennott and other members of the Board of Trade for his father William Rothbart and Rodman and that such transactions were "the precursor for the deception which followed" (App. A17). Further, the Court of Appeals conceded that in November, 1964 prior to the delivery of any stock, William Rothbart represented to Sennott that "he would get his stock options" (App. A19).[4] The Court of Appeals, however, dismissed William Rothbart's November, 1964 assurance to Sennott as not being at a pertinent time, although it recognized that a February, 1965 delivery of some shares by Jordan was a deception to forestall further inquiry by Sennott (App. A19, A22). The Court passed over in silence William Rothbart's sworn denial at trial of his assurance that the stock options would be delivered as well as William's sworn denial of Jordan's other solicitations of business for Rodman.

In short, although Rodman profited throughout 1964 to 1966 from the stock trades solicited by Jordan Rothbart (which solicitation was illegal in itself because Jordan Rothbart's license to act as a representative of any broker-dealer had been revoked by the NASD), the Court of Appeals held that Rodman was

4. As a result of this representation and repeated assurance of Jordan Rothbart summarized by the Court of Appeals (App. A19-21), Sennott continued to trade at Rodman engaging in more than $2,000,000 in trades between 1964 and 1966. Although at the time of trial Jordan Rothbart was impecunious (indeed, he did not even show up for trial), in November, 1964 he had between $136,000 and $145,000 in his trading account at the Board of Trade.

not liable for the fraudulent transactions because there were no facts showing that Rodman, through William Rothbart or otherwise, had knowledge of such fraudulent transactions at the time the money for the bogus stock options was given to Jordan Rothbart.

This same lack of knowledge was also held by the Court of Appeals to defeat recovery by the Sennotts from Rodman on the basis that Rodman aided and abetted such fraudulent transactions and/or was a controlling person as that is defined in Section 20(a) of the Securities Exchange Act of 1934 (15 U. S. C. § 78t) (App. A25-26).

## REASONS FOR GRANTING THE WRIT.

This case presents three issues of importance in determining the scope of the liability of a broker-dealer under the federal securities laws for fraudulent stock transactions by persons who are soliciting stock trading business on its behalf. By requiring actual prior knowledge of such fraudulent stock transactions before a broker-dealer may be found (1) to have violated the federal securities laws, (2) to have aided and abetted violations of the federal securities laws or (3) to be liable as a controlling person under the securities laws, the Court of Appeals for the Seventh Circuit has decided questions of Federal law which have never been directly ruled upon by this Court in a way which departs from the announced policies of Congress and this Court and from decisions of other federal courts. This Court previously granted *certiorari* in *Kamen & Co.* v. *Paul H. Aschkar & Co.*, 382 F. 2d 689 (9th Cir. 1967) *cert. granted* 390 U. S. 942 (1968) to consider issues one and three. *Certiorari* was later dismissed pursuant to Rule 60 of this Court by agreement of the parties, 393 U. S. 801 (1968).

## I.

### A Broker-Dealer Must Be Liable For Actions of Its Representative.

The Congress of the United States in 1934 declared that a fair and honest market in securities is affected wih a national public interest. To further that public interest, Congress imposed extensive civil liabilities for misrepresentations and other fraudulent conduct (Securities Act of 1933 §§ 11 and 12; 15 U. S. C. §§ 77k and 77l), required the licensing of members in the securities industry (Securities Exchange Act of 1934, 15(a), 15 U. S. C. A. § 780(a), and declared unlawful manipulative and fraudulent acts (Securities Act of 1933 §17, 15 U. S. C. § 77q; Securities Exchange Act of 1934 § 10b and 15c; 15 U. S. C. § 78j, 78o). Since the enactments of these sections the courts have imposed civil liability for the conduct which these sections and the rules thereunder have declared unlawful. Indeed, civil suits are a "necessary supplement" to the enforcement powers of the Securities and Exchange Commission, *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 432 (1964).

This Court during the last term reaffirmed these purposes in *Affiliated UTE Citizens of Utah* v. *U. S.*, 406 U. S. 128 (1972) stating (406 U. S. at 151):

> "These proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.' Securities & Exchange Commission v. Capital Gains Research Bureau, 375 U. S. 180, 186, 84 S. Ct. 275, 280, 11 L. Ed. 2d 237 (1963). In the case just cited the Court noted that Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to

effectuate its remedial purposes.' *Id.*, at 195, 84 S. Ct. at 285. This was recently said once again in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U. S. 612, 92 S. Ct. 165, 169, 30 L. Ed. 2d 128 (1971)."

In the instant case, respondent allowed Jordan Rothbart to hold himself out as their representative for the purpose of soliciting stock business on the Chicago Board of Trade and profited from such solicitations. Such solicitations were also the "precursor" of the fraudulent transaction in question; indeed, included in that trading was participation in a public offering of Skyline Homes stock which resulted in an immediate profit for Sennott. Counting on such immediate profit developing and gaining respectability by acting as an agent for Rodman, Jordan Rothbart developed the scheme to defraud Sennott by offering him another good buy in Skyline Homes stock. In other words, the fraudulent transaction was intricately related to the previous transactions.

The Court of Appeals' holding that under such circumstances an employer may nevertheless escape from liability wholly strips from the public the protection that the federal securities acts were intended to provide. The Court of Appeals' holding reduces the protection of the public by restricting securities fraud victims to fruitless suits against impecunious representatives and immunizes the profit-taking members of the securities business from the duties and liabilities that Congress and the courts have heretofore imposed. The public policy underlying the securities acts and the cases imposing civil liability for violation of such acts require at the very least that a securities firm be held responsible for violation of the acts committed by its representatives in the sales of stock.

The Ninth Circuit in *Kamen & Co.* v. *Paul H. Aschkar & Co.*, 382 F. 2d 689 (9th Cir. 1967), *cert. granted* 390 U. S. 942, *cert. dismissed* 393 U. S. 801 (1968),[5] like the Seventh

5. The case was dismissed pursuant to Rule 60 of the Supreme Court rules by agreement of the parties.

Circuit in the case at bar, also excused a broker-dealer from liability based on its narrow reading of the scope of the securities acts and the requirements at common law for "apparent authority." In its brief to this Court in that case prior to the agreed dismissal, the Securities and Exchange Commission as *amicus curiae* made its position clear with respect to the issue of broker-dealer liability for the fraudulent actions of its representatives. It stated:

> "We submit that the interests that Congress sought to protect when it enacted the 1933 and 1934 securities acts can be effectively promoted only by recognizing that broker-dealers are as a matter of courses [*sic*] responsible in damages to persons whom their employees have defrauded in connection with their employment with the firm. Because of the pervasive prophylactic purposes of the federal legislation, broker-dealers should be held to a rigorous standard of responsibility for the acts of their employees, without resort to such nice refinements of common law agency principles as 'apparent' or 'ostensible' authority.
>
> "The securities acts were passed because it was recognized that investors needed protection in securities transactions. In transmitting to Congress his recommendation for legislation in this field, the President wrote: 'This proposal adds to the ancient rule of caveat emptor, the further doctrine "let the seller also beware." ' Securities are intricate merchandise,' and Congress recognized that the common law rules developed to deal with transactions involving property of a more traditional nature were inapproprate to the sophisticated transactions involving securities.
>
> * * * * *
>
> "In its administrative disciplinary proceedings the Commission has long recognized this crucial distinction and has invariably held that a violation of the securities laws by officers or employees of a broker-dealer firm acting within the scope of their employment is necessarily a violation by the firm itself, and that the degree of fault on the part of the firm is a factor to be considered only

in determining the sanction, if any, to be imposed. *E.g., Cady, Robert & Co.*, 40 S. E. C. 907, 911; *H. F. Schroeder & Co.*, 27 S. E. C. 833, 837; *E. H. Rollins & Sons, Inc.*, 18 S. E. C. 347, 379 and n. 45; cf. *National Association of Securities Dealers, Inc.*, 20 S. E. C. 508, 515-516.

* * * * *

"There is no sound reason why this same rule should not obtain in the realm of a civil suit where the person actually injured by the fraud seeks to be made whole by the firm with which he was dealing. *Many, probably a majority, of the frauds practiced by securities firms involve misconduct by employees—typically by sales representatives who make false or unfounded representations with respect to securities. It is the Commission's experience that from time to time salesmen actually whet the appetites of gullible public customers by representing that they are breaking their employers' rules by giving them a special deal;* for example, by giving them more than the prescribed quota of a new issue of securities. *But, whatever the representations made by the salesmen or other employees of the broker-dealer, we have found that investors customarily rely primarily on the integrity, reputation, and responsibility of the firm itself rather than on the character of the particular employee with whom they happen to be dealing.* It is the firm that is accepting and retaining the profits from the transactions, as Kamen & Co. did in this case; and it is the firm to whom the customer should be permitted and expected to look if his trust has been abused.

"When a securities firm confers upon its employees the authority to engage in transactions far beyond the financial resources of the individual employees, public investors should not be required to ponder whether that firm has also given those employees confidential instructions limiting that authority, or be required to abstain from participation in a securities transaction without first consulting a managing partner to ascertain the metes and bounds of the authority of the firm's representative." (Emphasis supplied.)

In *Kamen & Co.* v. *Paul H. Aschkar & Co., supra,* 382 F. 2d 689 (9th Cir. 1967), *cert. granted* 390 U. S. 942, *cert. dismissed* 393 U. S. 801 (1968), the persons who actually committed the fraud were employees of the broker-dealer. In the present case, Rodman knowingly allowed a person who had previously defrauded customers of a broker-dealer and had his license as a representative of any broker-dealer revoked by the NASD as a result of such action to solicit much profitable stock business on the Board of Trade and when he again defrauded a customer Rodman's claim of "caveat emptor" was upheld by the Court of Appeals! Such a holding undermines the whole purpose of the federal securities laws.

Indeed, although federal courts have held that the duties of a securities broker are, if anything, more stringent than those imposed by general agency law, See *Opper* v. *Hancock Securities Corp.,* 250 F. Supp. 668 at 676 (S. D. N. Y. 1966) *aff'd* 367 F. 2d 157 (2d Cir. 1966), the Court of Appeals has excused Rodman from liability which would be imposed under modern common law principles. The case of *Blackburn* v. *Witter,* 201 Cal. App. 2d 518, 19 Cal. Rptr. 842 (5th Dist. Ct. App. 1962) illustrates this very clearly. There a registered representative of the defendant brokerage house persuaded plaintiff to invest in stock of a nonexistent company. Plaintiff, as did Sennott in this case, sold some stock through the brokerage house to get the money to invest in the non-existent stock. And, as in this case, the registered representative gave plaintiff commercial "rediform" receipts which he later supplemented with a promissory note. In affirming the trial court's holding that the brokerage house was liable for the acts of its registered representative, the court stated (19 Cal. Rptr. at 844-845):

> "It is contended that the transaction whereby respondent gave Long the money and took back a receipt and a note, differed so radically from the stock purchase and sale transactions previously had with Long, that it cannot be said that respondent was misled. Appellants ably argue that as a reasonable person, respondent must have known

that Long was acting for himself and not on behalf of either brokerage house when he took her money for investment. However, the trial court found to the contrary, and the familiar rule that the trier of fact is the sole judge of the credibility of the witness and of the weight of the evidence, is applicable."

* * * * *

"It [the testimony] also presents the rather nice question of how appellants can concede that the part of the transaction by which respondent sold her stock through Long and the brokerage house to obtain the money was within the scope of Long's agency, while the part of the transaction whereby Long received the proceeds of the stock sale was not within the scope of his apparent authority. In short, it is difficult to see how appellants can accept the benefits of the sale of the stock by Long as their agent and deny liability for the fraudulent misuse of the money obtained by the sale of the stock."

* * * * *

"Mr. Smith of Walston and Company stated that Walston and Company knew Long was drinking in excess, gambling heavily, and encouraging customers to buy and sell stock merely for the purpose of promoting volume so that his commissions would be greater. Walston and Company did nothing to advise the customers of this nor of any stock exchange, customer or agent regulations. Walston and Company and Dean Witter and Company knew that this is a highly specialized and technical business, and customers rely on their employees for advice, guidance and consultation. In this case, brokerage houses placed defendant Long in position to defraud their customers. It is the finding of the Court that plaintiff acted with ordinary care."

The Seventh Circuit, in *SEC* v. *First Securities Co. of Chicago*, 463 F. 2d 981, *cert. denied* 409 U. S. 880 (1972), in holding a broker-dealer liable for the personal fraud of its president relied on *Blackburn* stressing that the registered representative in *Blackburn* gave the defrauded customer receipts which were different from those used by his employer and that

"the customer admitted that the transactions with Long [the representative] were never reflected in periodic summaries of her transactions" (463 F. 2d at 986) received from the broker-dealer.

Yet, the Court of Appeals in the case at bar attempts to distinguish the *Blackburn* case on the basis that the customer there "believed that he was purchasing stock through the brokerage house *in the same manner* as he had previously made purchases, and, as such, was relying on the expertise and integrity of the brokerage" (Emphasis supplied.) (App. 25). Since, exactly as in the case at bar and as stressed in *First Securities,* the customer in *Blackburn* was given commercial receipts supplemented by a personal promissory note from the representative, it is impossible to discern the basis of the distinction that the Court of Appeals tries to make.

It is general common law doctrine that a principal is liable to a third party for frauds committed by its agents even though those acts be unauthorized or even contrary to the principal's explicit instructions. See *NLRB* v. *Intl. Longshoremen's & Warehousemen's Union,* 283 F. 2d 558, 565 (9th Cir. 1960). In *J. C. Millett* v. *Park & Tilford Distillers Corp.,* 123 F. Supp. 484, at 495-96 (N. D. Calif. 1954) the court stated:

> "Park & Tilford would be liable for Cooperman's fraud only if he was acting within the scope of his employment. In a very real sense Cooperman's authority did not extend to making the fraudulent statements but that is not required. The question is whether the statements were made *in relation to the subject matter or business dealing in which the agent had authority.* The principal is liable for placing his agent in a position which enables the agent while apparently acting within the scope of his authority to commit a fraud. Here Cooperman's authority as Western Sales Manager, extended to negotiating with and ob-

taining distributors for the Company. Even though he had no final authority in their ultimate selection, obtaining the distributor's consent to take on Park & Tilford's products was clearly within his authority. Millett reasonably so understood it. The representations went to the heart of this function. Park & Tilford is liable." (Emphasis supplied.)

The fraudulent statements made by Jordan Rothbart to Sennott relating as they did to stock transactions were made "in relation to the subject matter or business dealing in which the agent had authority." Had Jordan Rothbart been a registered representative of Rodman, liability of Rodman would have been unquestioned. The fact that he was not a registered representative, indeed, could not be because of his previous violations of the federal securities laws, should not be permitted to excuse Rodman. If anything, Rodman is even more culpable since they allowed him to solicit stock transactions knowing that he had defrauded brokerage customers before.

In sum, the policies embodied in the Securities Act of 1933 and Securities Exchange Act of 1934 require that a broker-dealer who has placed a representative whether licensed or not in a position to commit a fraud and who has reaped profit from a continuing relationship between such representative and the defrauded customer be held liable to its defrauded customer regardless of any subjective fault on the part of the broker-dealer. The foregoing is especially true where, as here, one of the partners in the broker-dealer has made representations to cover up and perpetuate the effectiveness of the fraud. The protection of the public interest against fraudulent practices in the securities business requires a high degree of self-regulation and supervision of those who enter an industry which has all too often had a special attraction for the dishonest. Such pro-

tection can only be obtained by holding a broker-dealer liable for all violations of the federal securities laws committed by its representatives whether licensed or not.

## II.

### A Broker-Dealer Must Be Liable for Aiding and Abetting Violations of Securities Acts.

The Court of Appeals by requiring "knowledge of the fraudulent acts" (App. A25) in order for Rodman to be found to have aided and abetted a violation of the federal securities laws has, in effect, written this doctrine right out of the law.[6] If actual knowledge is required then what is necessary to show aiding and abetting is no different than what is required to show a direct violation of the securities laws. The correct determination of what is necessary to prove aiding and abetting a violation of the federal securities laws is an important question of law never decided by this Court.

The present scope of the doctrine of aiding and abetting was summarized in *SEC* v. *First Securities Co. of Chicago*, 463 F. 2d 981 at 987 (7th Cir.), *cert. denied* 409 U. S. 880 (1972):

> "It is clear that one who aids and abets a violation of section 10 of the Securities Exchange Act of 1934 and Rule 10b-5 may be held civilly liable to one who is injured thereby. Brennan v. Midwestern United Life Ins. Co., 417 F. 2d 147 (7th Cir. 1969); Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F. 2d 135 (7th Cir. 1969); Anderson v. Francis I. DuPont & Co., 291 F. Supp. 705 (D. Minn. 1968); Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane, *supra*. Moreover, *liability predicated on aiding and abetting may be founded on less than actual knowledge and participation in the activity proscribed by section 10 and Rule 10b-5*. Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., *supra*, 410 F. 2d at 144." (Emphasis supplied.)

6. Indeed, in addition to actual knowledge, the Court of Appeals requires knowledge at what it deems "a pertinent time", i.e., before the money changes hands (App. A22).

In *Buttrey* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 410 F. 2d 135 (7th Cir.), *cert. denied*, 396 U. S. 838 (1969), the broker-dealer defendant was found liable as an aider and abetter to violations of Rule 10b-5 committed by a *customer* of the brokerage firm because it had allowed the customer to trade in securities through a cash account in spite of his known financial instability and erratic trading practices. And, in *Anderson* v. *Francis I. DuPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968), the Court held that the broker-dealer defendant could be found liable as an aider and abetter to violations of Rule 10b-5 committed by a *customer* of the brokerage firm to which it gave office space even though none of the money in question went directly from the plaintiffs to the brokerage firm; rather they received promissory notes from the *customer*.

In the case at bar, Rodman clearly facilitated the fraud because, as even the Court of Appeals admits (App. A22), Rodman knew that Jordan Rothbart (who had previously been found by the SEC to have defrauded brokerage customers and indeed was unable to legally act for any brokerage house because his license to act as a representative of any member of the NASD had been revoked) was soliciting stock business for it. No steps were taken to stop this practice—Rodman chose to profit from it on over $2,000,000 of stock transactions. These transactions, as the Court of Appeals also admits, were the "precursor of the deception" (App. A17). In other words, without such transactions, the fraud would not have taken place. *And*, if Rodman, knowing of Jordan Rothbart's stock solicitations, had informed Sennott of Rothbart's past and stopped such solicitations the fraud would not have taken place. Clearly, it aided and abetted such violation. In addition, even the Court of Appeals had to admit that William Rothbart had knowledge in November, 1964 before any stock was delivered of the dealings of Jordan Rothbart in such fraudulent transactions since at that time he told Sennott he would get the option stock (App. A19). But this action which covered up and

prolonged the fraud and protected the $2,000,000 in stock business for Rodman was dismissed by the Court of Appeals as not being at a pertinent time (App. A22).

Aiding and abetting is a doctrine which federal courts have found useful and necessary to limit securities frauds. The doctrine has been flexibly applied to effectuate the remedial purposes of the federal securities laws—full disclosure in all securities dealings and a *high standard of business ethics in the securities industry*. If actual knowledge, indeed actual knowledge prior to money changing hands, is required to show aiding and abetting, that doctrine is removed as an effective tool in the control of frauds—a technical defense is constructed since in almost all cases of stock fraud the broker-dealer will not have such actual knowledge of what its representatives are doing. The era of *caveat emptor* will have returned.

## III.

### A Broker-Dealer's Liability as a Controlling Person Under the Securities Acts.

The Court of Appeals also misconstrued the scope of the controlling person section of the Securities Exchange Act of 1934. Knowledge was again required as a precondition of liability. In addition, the Court of Appeals required that Rodman itself be directly involved. These requirements make available technical defenses contrary to the liberal interpretation of the securities laws frequently stressed by this Court with respect to the federal securities laws in general and by the Eighth Circuit with respect to the controlling person sections in particular in *Myzel* v. *Fields*, 386 F. 2d 718 (8th Cir. 1967), *cert. denied*, 390 U. S. 951 (1968).

Section 20(a) of the Securities Exchange Act provides as follows:

> "Sec. 20. (a) Every person who, directly or indirectly, controls any person liable under any provision of this title

> or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

In interpreting this section the Eighth Circuit in *Myzel* v. *Fields, supra,* stated (386 F. 2d at 718):

> "The statute is remedial and is to be construed liberally. It has been interpreted as requiring only some indirect means of discipline or influence short of actual direction to hold a controlling person liable."

And, in *Richardson* v. *MacArthur,* 451 F. 2d 35, at 41 (10th Cir. 1971), the Tenth Circuit stated that "Liability under § 20(a) is not restricted by principles of agency or conspiracy." See also, *Anderson* v. *Francis I. DuPont & Co.,* 291 F. Supp. 705, 710 (D. Minn. 1968) (controlling person statute not limited to the employer-employee relationship).

The Court of Appeals in the case at bar does not follow these guidelines—it states that in the absence of actual knowledge "we do not see how Rodman can be found to have acted in bad faith" (App. A26). Under such an interpretation broker-dealers would have far less responsibility for acts of their representatives than any other industry since only actual knowledge of wrongdoing would render the broker-dealer liable. Thus, an Act which was clearly intended to extend *additional* protection to the public has been interpreted to strip the public of vital protection it formerly possessed.[7]

The facts of this case illustrate the dangers of the requirement of actual knowledge. The Court of Appeals recognizes

7. The requirement of direct involvement has the same result. As *Blackburn* v. *Dean Witter,* 201 Cal. App. 2d 518, 19 Cal. Rptr. 842 (5th Dist. Ct. App. 1962) and *SEC* v. *First Securities Co. of Chicago,* 463 F. 2d 981 (7th Cir.), *cert. denied,* 409 U. S. 880 (1972) make clear, even if a representative acts for his own personal profit and defrauds a securities customer, the broker-dealer is liable under common law principles.

that the meeting in November, 1964 attended by Vernon Carroll, managing partner of Rodman, Sennott and William and Jordan Rothbart, "warrants detailed scrutiny" (App. A18).[8] Yet the Opinion overlooks the fact that Carroll on that occasion withheld from Sennott knowledge about the Rothbarts that he should have disclosed. What Carroll knew in November, 1964, what Sennott did not know and what Carroll failed to tell Sennott at the meeting was (1) that Jordan Rothbart could not lawfully sell any stock for any brokerage house or company because he had been previously found by the SEC to have violated the anti-fraud provisions of the Securities Act while employed by another broker-dealer and, consequently, his registration as a representative of any member of the National Association of Securities Dealers had been revoked, (2) that despite his regular involvement in Sennott's trades through Rodman, Jordan Rothbart was not officially associated with Rodman and (3) that William Rothbart was "by his nature, willing to take more liberties than our firm would permit". Carroll said nothing to Sennott about these matters even though Carroll was then of the view, and said so, that Sennott's Rodman account was being "churned" by William and Jordan Rothbart.

Carroll obviously thought something must be wrong when he learned, had *actual* knowledge, that Sennott was giving money to Jordan Rothbart for some purpose, but he took no steps to disclose to Sennott fully what he knew in the hope that any problem would be corrected. Rather, Rodman's managing

8. The purpose of this meeting was to inquire as to why Rodman checks payable to Sennott had ended up in Jordan Rothbart's wife's bank account. Some of the checks delivered to Jordan Rothbart by Sennott had been received from Sennott for the sale of stock in one of the accounts Sennott had at Rodman. Prior to this meeting, William Rothbart had told Sennott not to tell Carroll anything, that it was none of his business, and that Sennott should not worry, he would get his stock options. Sennott followed William Rothbart's direction. Neither William nor Jordan who attended the meeting said anything either. Indeed, Jordan gained more respectability by being at the meeting since this was completely consistent with his holding himself out as an agent of Rodman.

partner Carroll walked away and knowingly left Sennott at the mercy of Rodman partner William Rothbart and Rodman's unregistered and unlicensed salesman Jordan Rothbart.

The dangers of requiring actual knowledge are evident—diligence in seeking to protect its customers from fraud will be replaced by ignoring such possibilities since investigation may develop actual knowledge and thus liability. The controlling person section must be interpreted liberally to achieve its purpose—protection of the stock customers.

## CONCLUSION.

Richard J. Sennott and Joan Sennott respectfully request that for the foregoing reasons this petition for a writ of certiorari be granted. The questions presented are of substantial importance in the interpretation of the Securities Act of 1933 and the Securities Exchange Act of 1934 and will have a serious effect on the private enforcement of the anti-fraud provisions of these Acts and on the protection of the public against fraud in the securities market.

Respectfully submitted,

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## APPENDIX A.

IN THE UNITED STATES DISTRICT COURT
for the Northern District of Illinois
Eastern Division

RICHARD J. SENNOTT and JOAN SENNOTT,
*Plaintiffs,*
*vs.*
JORDAN E. ROTHBART, WILLIAM ROTHBART and RODMAN & RENSHAW, a partnership,
*Defendants.*

RODMAN & RENSHAW, a partnership,
*Cross-Plaintiff,*
*vs.*
JORDAN E. ROTHBART and WILLIAM ROTHBART,
*Cross-Defendants.*

RODMAN & RENSHAW, a partnership,
*Counter-Plaintiff,*
*vs.*
RICHARD J. SENNOTT and JOAN SENNOTT,
*Counter-Defendants.*

No. 67 C 424

FINDINGS OF FACT AND CONCLUSIONS OF LAW.

This cause coming on for trial on the merits of the Amended Complaint, the answers and amendment to answer thereto; the counterclaim and reply thereto; and amended cross claims and

answers thereto, the Court having heard the evidence, having considered the memoranda of counsel for the parties and being fully advised in the premises, now finds:

## FINDINGS OF FACT.

This is an action for violation of the Securities Act of 1933 and the Securities Exchange Act of 1934.

1. Plaintiffs Richard J. Sennott and Joan Sennott are residents of the State of Illinois. At all times relevant to this proceeding, Richard Sennott was a member of the Chicago Board of Trade and an officer of Honeymead Trading Corporation.

2. Defendant Jordan Rothbart during the period 1963 to 1966 was a resident of the State of Illinois and a member of the Chicago Board of Trade. His present place of residency is unknown.

3. Defendant William Rothbart is now a citizen of the State of Florida. At all times relevant to this action, he was a resident of the State of Illinois and a partner in Rodman & Renshaw.

4. Defendant Rodman & Renshaw is a registered broker-dealer in securities and a member firm of the New York Stock Exchange, with its principal place of business at 209 South LaSalle Street, Chicago, Illinois.

5. In late 1963, defendant Jordan Rothbart asked Richard Sennott on the floor of the Board of Trade if he would like to open an account and purchase stock through Rodman & Renshaw. He told Sennott that his father who was a partner at Rodman & Renshaw had made money on the stock market for several other members of the Board of Trade. Sennott told Jordan Rothbart that he had no experience in investing in stocks, but that, if Jordan had any recommendations about stock, to tell him and he might invest. Subsequently, Jordan Rothbart suggested that Sennott buy or sell certain stocks and Jordan Rothbart executed the orders he received from Sennott through

Rodman & Renshaw. Prior to purchasing stock through Jordan Rothbart and Rodman & Renshaw, Sennott had only purchased six or seven securities in his entire life.

6. A pattern developed which continued from 1964 through the spring of 1966 whereby Rothbart recommended stock purchases or sales to Sennott and executed the many resulting orders through Rodman & Renshaw.

7. At the time Sennott opened his first account at Rodman & Renshaw in January 1964, his only link with Rodman & Renshaw was Jordan Rothbart. Sennott did not meet either William Rothbart or Glen Rothbart until April 1, 1964. By 1965, Sennott had opened six more accounts at Rodman & Renshaw—one in his own name, others for his children and one each for the Honeymead Trading Corporation Profit Sharing Fund and the Honeymead Trading Corporation Pension Fund.

8. In February 1964, pursuant to the previously established course of conduct, Jordan Rothbart recommended to Sennott that he purchase some Skyline Homes, Inc. stock in an upcoming secondary public offering of such stock for which Rodman & Renshaw was acting as lead underwriter. Pursuant to this recommendation, Sennott directed Jordan Rothbart to order 2,000 shares of Skyline Homes, Inc. stock for him.

9. Subsequent to this initial order of Skyline Homes, Inc. stock, but prior to its delivery, Jordan Rothbart again approached Sennott with another chance to purchase Skyline Homes, Inc. stock. Rothbart told Sennott that a number of options for the purchase of Skyline Homes, Inc. stock had been made available to him, that the options had initially been offered to his father William R. Rothbart, a partner in Rodman & Renshaw, in return for services his father had rendered Skyline Homes, Inc. in the secondary public offering referred to above and also for helping Skyline Homes, Inc. become listed on the American Stock Exchange, but that, when Rothbart's father turned down the offer because SEC regulations forbid such transactions on

the part of broker-dealers, the options had been made available to him. Jordan Rothbart said that he was willing to exercise some of the options on behalf of Sennott. Jordan Rothbart also told Sennott that he was going to exercise some of the options for himself and that all the money for the options would be held in escrow in New York City until the time came for the exercise of the option rights. He told Sennott that the options would be exercised for shares of Skyline Homes, Inc. stock within seven months and that he would then deliver shares of said stock to Sennott at a price of $26.50 per share.

10. Relying on these representations and further repeated assurances from time to time that more options had been made available to Jordan Rothbart, Richard Sennott paid Jordan Rothbart $132,000 between March, 1964 and October, 1964.

11. In late September, 1964, Sennott also gave Jordan Rothbart an additional $10,000 for Skyline Homes, Inc. options on behalf of the Honeymead Trading Corporation Profit Sharing Fund of which he was one of three trustees.

12. In September, 1964, Skyline Homes, Inc. stock split 2 for 1 and the agreed price for the option shares became $13.25.

13. In November, 1964, William Rothbart contacted Sennott and informed him that Vernon Carroll, another partner in Rodman & Renshaw, had some questions relating to some checks delivered by Rodman & Renshaw to Sennott and wanted to meet with Sennott. Prior to such meeting in Carroll's office, William Rothbart met Sennott at the door of Rodman & Renshaw and told him that if Sennott told Carroll nothing about the checks, Sennott would get the Skyline Homes, Inc. stock as promised him by Jordan Rothbart.

14. At the meeting in Carroll's office attended by Carroll, Sennott, William Rothbart and Jordan Rothbart, Carroll inquired why certain checks drawn by Rodman & Renshaw and delivered to Sennott had ended up in Dolores Rothbart's bank account. Sennott, following the instructions of William Roth-

bart, refused to answer this question. At the time of this meeting Sennott did not know that the representations made to him by Jordan Rothbart with respect to the availability of Skyline Homes, Inc. stock at $13.25 per share were false.

15. At the meeting in his office, Carroll did not tell Sennott about Jordan Rothbart's previous conduct in violation of the federal securities law; the known laxity of William Rothbart toward securities regulations or the fact that Jordan Rothbart was not associated with Rodman & Renshaw. Sennott knew none of these things at the time of the meeting.

16. Subsequent to this meeting in Carroll's office, Sennott was given two letters by Rodman & Renshaw and asked to sign one letter and have his wife sign the other. The letters were not explained to him by Rodman & Renshaw.

17. After repeated requests by Sennott both in person and in phone conversations with Jordan Rothbart for delivery of the promised Skyline Homes, Inc. stock, and in an effort to further conceal the true facts, Jordan Rothbart delivered 2,400 shares of Skyline Homes, Inc. stock to Sennott between February 26, 1965 and January 20, 1966 which were worth $31,800 at the agreed price of $13.25 per share. The stock which was delivered was purchased by Jordan Rothbart through the brokerage firms of Golkin, Bombeck & Co., Inc. and First Hanover Corporation. No other Skyline Homes, Inc. stock has been delivered by Jordan Rothbart or William Rothbart to Sennott nor has any money been returned to Richard Sennott.

18. In fact, no options were available to Jordan Rothbart, William Rothbart or Rodman & Renshaw for the purchase of shares of Skyline Homes, Inc. stock. The statements made to Sennott by William Rothbart and Jordan Rothbart were false and known to be false at the time they were made.

19. In addition to Sennott, Jordan Rothbart solicited the stock business of at least five other members of the Board of Trade and executed the resulting orders for the purchase or sale

of stock through Rodman & Renshaw. None of these other members of the Board of Trade had any contact with anyone associated with Rodman & Renshaw except Jordan Rothbart.

20. Rodman & Renshaw maintained a direct telephone line from the Board of Trade to its office. This direct line was under the control of one of its employees stationed at the Rodman & Renshaw booth on the Board of Trade floor. The persons who used this phone were Richard Rose, a partner in Rodman & Renshaw, Jim Lynch, a broker for Rodman & Renshaw and Jordan Rothbart. Jordan Rothbart used the direct line from the Board of Trade to Rodman & Renshaw three or four times a day in 1964 to 1966 to inform William Rothbart and Glen Rothbart of the business solicited. William Rothbart and Glen Rothbart also used the direct line to call Jordan Rothbart.

21. William Rothbart knew that Jordan Rothbart was soliciting stock business on the Board of Trade on behalf of William Rothbart and Rodman & Renshaw and shared the commissions on such business with his son Glen Rothbart.

22. Rodman & Renshaw knew, or should have known, that Jordan Rothbart was soliciting stock business for it on the Board of Trade and executing the resulting stock orders through Rodman & Renshaw.

23. Rodman & Renshaw was in a position to control, directly or indirectly, the conduct of William Rothbart and Jordan Rothbart in their solicitation of stock business on the Board of Trade.

24. Rodman & Renshaw was the agent of Richard Sennott and Joan Sennott in executing the many stock transactions in the seven accounts opened by Sennott at Rodman & Renshaw.

25. At no time did Rodman & Renshaw, or any of its representatives, including William Rothbart, inform Sennott that Jordan Rothbart was not an agent or employee of Rodman & Renshaw, that Jordan Rothbart had been found by the Securities and Exchange Commission to have previously violated the Se-

curities Act of 1933 and the Securities Exchange Act of 1934 or that Jordan Rothbart's membership as a representative of a member of the National Association of Securities Dealers had been revoked.

26. William Rothbart had a fiduciary duty to Rodman & Renshaw not to engage in practices which were contrary to the rules of Rodman & Renshaw and of the stock exchanges and applicable statutes. Such duty included a duty not to do business through unauthorized representatives and a duty not to engage in fraudulent transactions.

27. William Rothbart voluntarily entered into a letter-agreement dated August 23, 1968 with Rodman & Renshaw pursuant to which he agreed to pay Rodman & Renshaw's legal expenses in connection with this action.

28. The Findings of Fact set forth above were established either by stipulation or from the testimony of the witnesses called in plaintiffs' behalf at trial, which testimony the Court expressly accepts as true.

## CONCLUSIONS OF LAW.

1. The Court has jurisdiction of the parties and the subject matter. 15 U. S. C. 77v and 78aa.

2. Plaintiffs have established by a preponderance of the evidence that Jordan Rothbart made false representations to Richard Sennott with respect to the purchase of shares of Skyline Homes, Inc. stock in violation of Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 adopted by the Securities and Exchange Commission thereunder, Section 9(a)(4) of the Securities Exchange Act of 1934, Section 12(2) of the Securities Act of 1933 and Section 17(a) of the Securities Act of 1933.

3. Plaintiffs have established by a preponderance of the evidence that William Rothbart knowingly assisted and partici-

pated in the efforts of Jordan Rothbart to defraud plaintiffs in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 adopted by the Securities and Exchange Commission thereunder, Section 9(a)(4) of the Securities Exchange Act of 1934, Section 12(2) of the Securities Act of 1933 and Section 17(a) of the Securities Act of 1933.

4. William Rothbart's knowledge of the solicitation of stock business by Jordan Rothbart on the Board of Trade from Richard Sennott and at least five other members of the Board of Trade and the false representations to Richard Sennott with respect to the sale of shares of Skyline Homes, Inc. stock was acquired within the scope of the partnership business of Rodman & Renshaw and, therefore, is imputed to and binding upon Rodman & Renshaw.

5. Plaintiffs have established by a preponderance of the evidence that Rodman & Renshaw knew, or should have known, of the illegal conduct of William Rothbart and Jordan Rothbart and, therefore, it is equally liable with them for the false representations to Richard Sennott with respect to the purchase of shares of Skyline Homes, Inc. stock.

6. Plaintiffs have established by a preponderance of the evidence that Rodman & Renshaw aided and abetted William Rothbart and Jordan Rothbart in their violations of the federal securities laws enumerated above in that, in breach of its fiduciary duty as a broker and agent for Sennott, it failed to disclose to Sennott the previous violations of the federal securities laws by Jordan Rothbart or the fact that it was improper for Jordan Rothbart to act as its representative.

7. Plaintiffs have established by a preponderance of the evidence that Rodman & Renshaw directly or indirectly controlled William Rothbart and Jordan Rothbart and, therefore, is liable jointly and severally with them since Rodman & Renshaw did not act in good faith in exercising such control. 15 U. S. C. 78t(a).

8. Defendants have failed to establish by a preponderance of the evidence that Richard Sennott knew, or should have known, that there was anything illegal or otherwise improper in his giving $132,000 to Jordan Rothbart for the purchase of shares of Skyline Homes, Inc. stock.

9. No conduct by Richard Sennott in his dealings with Jordan Rothbart, William Rothbart or Rodman & Renshaw was a violation by him of the federal securities laws.

10. Defendants have failed to establish by a preponderance of the evidence that plaintiffs are estopped from asserting their claims against Rodman & Renshaw for the reason that plaintiffs at no time acted so as to encourage Rodman & Renshaw or William Rothbart to reasonably rely on to their detriment after plaintiffs had sufficient knowledge to know that they had been defrauded.

11. The indemnity letters signed by plaintiffs by their terms do not apply to the transactions which are the subject of this litigation.

12. Defendant Rodman & Renshaw failed to introduce any evidence to support its allegations that plaintiffs acted in any way malicious and wilful in the filing of their complaint in this action and, therefore, failed to establish any basis for its claim for exemplary damages or any other damages.

13. Plaintiffs have established by a preponderance of the evidence that Jordan Rothbart's conduct in getting Richard Sennott to give him $132,000 in reliance upon false represenations constituted common law fraud and that William Rothbart conspired with Jordan Rothbart in such fraudulent conversion of the monies of plaintiff.

14. Plaintiffs have established by a preponderance of the evidence that Jordan Rothbart, William Rothbart and Rodman & Renshaw are jointly and severally liable to them for damages in the amount of $100,200 plus interest since October 2, 1964, the date of the last payment of money by plaintiffs to Jordan

Rothbart. Such damages are necessary to make plaintiffs as nearly whole as possible and to deprive defendants of any benefits they received as a result of the fraud.

15. The liability of Rodman & Renshaw is a direct and proximate result of the wrongful conduct by Jordan Rothbart and William Rothbart; and Rodman & Renshaw is entitled to judgment against Jordan Rothbart and William Rothbart for the amount of any judgment entered in favor of plaintiffs against Rodman & Renshaw on the amended complaint.

16. William Rothbart is liable to Rodman & Renshaw for its legal fees incurred in connection with the defense of this action under the letter of agreement dated August 23, 1968.

ENTER:

/s/ ALEXANDER J. NAPOLI
*United States District Judge*

Dated: October 30th, 1970.

IN THE UNITED STATES DISTRICT COURT

for the Northern District of Illinois

Eastern Division

RICHARD J. SENNOTT and JOAN SENNOTT,
*Plaintiffs,*
*vs.*
JORDAN E. ROTHBART, WILLIAM ROTHBART and RODMAN & RENSHAW, a partnership,
*Defendants.*

---

RODMAN & RENSHAW, a partnership,
*Cross-Plaintiff,*
*vs.*
JORDAN E. ROTHBART and WILLIAM ROTHBART,
*Cross-Defendants.*

---

RODMAN & RENSHAW, a partnership,
*Counter-Plaintiff,*
*vs.*
RICHARD J. SENNOTT and JOAN SENNOTT,
*Counter-Defendants.*

No. 67 C 424

## JUDGMENT ORDER.

This action coming on for trial before the Court, and the evidence adduced by the parties having been heard and the Court having made its Findings of Fact and Conclusions of Law,

IT IS HEREBY ORDERED and adjudged that plaintiffs Richard Sennott and Joan Sennott recover from defendants Jordan E. Rothbart, William Rothbart and Rodman & Renshaw the sum of $100,200 together with interest from and after October 2, 1964 and its costs herein; said defendants being jointly and severally liable for the above sums.

IT IS HEREBY FURTHER ORDERED and adjudged that defendant Rodman & Renshaw recover from cross-defendants Jordan E. Rothbart and William Rothbart the sum of $100,200 together with interest from and after October 2, 1964 and its costs herein.

IT IS HEREBY FURTHER ORDERED and adjudged that defend- and Rodman & Renshaw recover from cross-defendant William Rothbart all of its legal fees incurred in connection with this action.

ENTER:

/s/ ALEXANDER J. NAPOLI,
*United States District Judge.*

Dated: October 30th, 1970.

UNITED STATES DISTRICT COURT

Northern District of Illinois

Eastern Division

Name of Presiding Judge, Honorable Alexander J. Napoli

Cause No. 67 C 424 Date December 29, 1970

Title of Cause—Richard J. Sennott and Joan Sennott vs. Jordan E. Rothbart, William Rothbart and Rodman & Renshaw, a partnership.

All of Defendants' motions for a new trial or in the alternative to amend judgment are hereby denied except that the final judgment be and is hereby amended to award Plaintiffs' damages in the amount of $99,600 together with interest from and after October 2, 1964 and its costs herein.

Napoli, *J.*

IN THE UNITED STATES COURT OF APPEALS

For the Seventh Circuit

September Term, 1971 — April Session, 1972

No. 71-1201

RICHARD J. SENNOTT and JOAN SENNOTT,
*Plaintiffs-Appellees,*

*vs.*

RODMAN & RENSHAW,
*Defendant-Appellant.*

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 67 C 424

ALEXANDER J. NAPOLI, *Judge.*

Argued April 24, 1972 — Decided January 18, 1973

Before SWYGERT, *Chief Judge,* PELL, *Circuit Judge,* and LARAMORE, *Senior Judge.**

PELL, *Circuit Judge.* Appellant Rodman & Renshaw, a securities brokerage house and member of the New York Stock Exchange, appeals from an adverse judgment in the district court awarding appellees Richard and Joan Sennott damages of $99,600 plus prejudgment interest. Appellant was found vicariously liable for the damage caused Sennott and his wife by the fraudulent securities manipulations of Jordan Rothbart, a former associate of Rodman & Renshaw and son of a partner in the firm. Judgments were also entered against Jordan Roth-

* Senior Judge Don N. Laramore is sitting by designation from the United States Court of Claims.

bart and his father, William Rothbart. Only Rodman & Renshaw (Rodman) appealed.

Jordan Rothbart, a commodities speculator and securities dealer apparently possessed of persuasive sales ability but a lessor standard of integrity, had at one time but not subsequent to 1958, been an employee of Rodman. No express authority to act on behalf of that firm existed subsequent to 1958; indeed it fairly appears that he was at the times here involved persona non grata to Rodman notwithstanding his father's status as a partner therein. In 1962, the Securities and Exchange Commission in an order had held that Jordan had between 1955 and 1957, while employed by another broker-dealer, violated certain anti-fraud provisions of the Securities Act. In 1958, his registration as a representative of a member of the National Association of Securities Dealers, Inc. had been revoked because of deceptive practices in the sale of securities. The Sennotts were unacquainted with this background at any material time here involved.

Jordan became a member of the Chicago Board of Trade in 1960 and engaged thereafter as a trader for his own account in commodities. Through his dealings at the Board of Trade, Jordan became acquainted with Richard Sennott who was also an active trader. Sennott traded both for himself and for the Honeymead Trading Corporation of which he was an officer.

As their relationship developed, Sennott, a more experienced commodities trader, recommended various transactions to Jordan who reciprocated by encouraging Sennott to take advantage of Jordan's father's expertise in the securities market. Specifically, Jordan told Sennott that his father had made money in the stock market for several members of the Board of Trade and that if Sennott ever wished to open a stock trading account Jordan would have one opened for him at Rodman & Renshaw. Initially Sennott declined to act on Jordan's recommendations, but in January 1964, in response to Jordan's assertion that his father thought a particular stock was a good buy, Sennott asked

Jordan to purchase a limited number of shares for him. Jordan immediately went to the special Rodman telephone located on the floor of the Board of Trade and arranged for the purchase of Sennott's order through Rodman.

In the same month Jordan arranged for Sennott to open a trading account with Rodman in the name of his, Sennott's, wife. Trading through that account and six others which he subsequently opened, Sennott's trading volume with Rodman for the two-year period between 1964 and 1966 totalled more than $2,000,000. Approximately seventy per cent of this trading was done through accounts opened by Jordan Rothbart, and much of it was done on the recommendation of Jordan or his father. A typical transaction involved Jordan advising Sennott that his father believed a particular stock should be bought or sold, Sennott indicating a desire to purchase, and Jordan going to the Rodman phone on the Board of Trade floor and calling in the order. Shortly thereafter Sennott would receive a mailed confirmation slip from Rodman.[1] Sennott, of course, paid brokerage fees on all of these transactions.

In February 1964, Jordan and Sennott had a conversation on the floor of the Board of Trade during which Jordan told him that Skyline Homes, Inc. (Skyline) was about to be listed on the New York Stock Exchange but that the company needed more shares to be eligible. In an effort to meet the requirement, Skyline stock was made a secondary offering through Rodman & Renshaw at approximately $40 per share. Jordan's offer to procure a portion of this offering for Sennott was accepted, and it was agreed that Jordan would place an order with Rodman for 2,000 shares of Skyline. Sennott received the shares in April and went immediately to the offices of Rodman & Renshaw to deliver

1. The district court made the additional finding that Jordan Rothbart solicited orders for Rodman & Renshaw from at least five other members of the Board of Trade. These orders and sales were accomplished by the use of the Rodman telephone, and in each instance the member placing the order dealt exclusively with Jordan Rothbart.

a check for the shares. It was on this occasion that Sennott first met William Rothbart.

While there was nothing fraudulent or improper about this or the previous sales, it was the precursor for the deception which followed. In March 1964, shortly after the order for 2,000 shares of Skyline was placed but before Sennott met William Rothbart, Jordan approached Sennott with respect to the purchase of additional shares of Skyline stock, this time through stock options which allegedly had been made available to Jordan through his father's dealings with Skyline. The district court's Finding of Fact Number 9 correctly sets forth the representations made by Jordan Rothbart:

> ". . . Rothbart told Sennott that a number of options for the purchase of Skyline Homes, Inc. stock had been made available to him, that the options had initially been offered to his father William Rothbart, a partner in Rodman & Renshaw, in return for services his father had rendered Skyline Homes, Inc. in the secondary public offering referred to above and also for helping Skyline Homes, Inc. become listed on the American Stock Exchange, but that, when Rothbart's father turned down the offer because SEC regulations forbid such transactions on the part of broker-dealers, the options had been made available to him. Jordan Rothbart said that he was willing to exercise some of the options on behalf of Sennott. Jordan Rothbart also told Sennott that he was going to exercise some of the options for himself and that all the money for the options would be held in escrow in New York City until the time came for the exercise of the option rights. He told Sennott that the options would be exercised for shares of Skyline Homes, Inc. stock within seven months and that he would then deliver shares of said stock to Sennott at a price of $26.50 per share."

At the time these representations were made, Skyline was selling for approximately $40 per share. Lured by a discount of that magnitude, Sennott agreed to purchase Skyline stock through the option plan. On seven separate occasions between March 18 and October 2, 1964, Sennott placed orders and delivered

checks to Jordan Rothbart for Skyline stock at the option price. Payments for these orders totalled approximately $142,000.[2] No stock options of the type described by Jordan ever existed and the representations were obviously designed to defraud Sennott. Instead of depositing the payments in an escrow account in New York, Jordan placed each check in his wife's personal checking account at the First National Bank of Highland Park and subsequently used the money to pay his own substantial trading losses.

When Jordan Rothbart first proposed the purchase of Skyline stock through the option arrangement, it was agreed that neither party would divulge the nature of their dealings. In accordance with that agreement each of the seven payments was recorded only by handwritten cash receipts prepared by Sennott and signed by Jordan Rothbart.

When the stock which had been set for delivery on October 18, 1964, did not materialize, Sennott inquired as to the reason for the delay. He was told by Jordan that there was no reason for concern, that the temporary delay was caused by the S. E. C.'s refusal to list Skyline on the New York Stock Exchange until the company had more shareholders. Satisfied with this explanation and with Jordan's assurance that the stock would be forthcoming soon, Sennott took no further action with respect to the Skyline options until early November 1964 when he was summoned to a meeting with the managing partner of Rodman & Renshaw, Vernon Carroll.

The circumstances of this meeting warrant detailed scrutiny. In October or early November, Jordan Rothbart approached Sennott on the floor of the Board of Trade and asked him to accompany him to a public phone to speak with William Rothbart. In the course of their conversation, William Rothbart told Sennott that Mr. Carroll wanted to meet with him to discuss the Skyline options but that the matters which Mr. Carroll wished to

2. $10,000 of the amount was paid by Honeymead and is not involved in this appeal.

discuss were none of his business. Sennott was then advised not to cooperate with Carroll. Accompanied by Jordan, Sennott went to the offices of Rodman & Renshaw that afternoon to meet with Carroll. Jordan's father met them at the door and again told Sennott the option transactions were none of Carroll's business. At this time, he also added that Sennott should not worry, he would get his stock options. All three men then went to Carroll's office where Carroll produced several of the checks Sennott had given Jordan Rothbart for the options. Carroll then sought to question Sennott with respect to how the checks happened to have [been] endorsed by Dolores Rothbart (Jordan's wife) and deposited in her account in the First National Bank of Highland Park. Sennott, while admittedly shocked by this revelation, told Carroll it was none of his business and refused to disclose the nature of his dealings with Jordan. Immediately after the conference, Sennott asked Jordan Rothbart about the checks and was told that they were deposited in the Rothbart account so Jordan, who asserted he was purchasing equal amounts of Skyline stock, could pay for the total stock purchase with a single check. Apparently this explanation satisfied Sennott since he made no further inquiries on the matter. Indeed, when again summoned to Carroll's office a few weeks later, he voluntarily signed a letter of indemnity protecting Rodman & Renshaw from liability for any failure on their part to investigate fully the signatures on the checks.

However, when several months had passed without delivery, Sennott again pressed Jordan for an explanation. On February 26, 1965, as a result of this inquiry, Jordan delivered 1,000 shares of Skyline common stock in street name to Sennott. This stock was purchased through Jordan's own broker, not Rodman & Renshaw, on the open market and merely signed over to Sennott in an effort to deceive him into believing he was receiving part of his "stock options." The deception was effective for, although Sennott continued his requests for the balance of the stock, he made no further inquiry into the actual facts surrounding the late options.

Between February 26, 1965, and January 20, 1966, Jordan delivered an additional 2,200 shares of Skyline common stock to Sennott. Delivery of this stock was made in six installments. As before, each delivery consisted of stock purchased on the open market for the market price. As set forth in detail below, the value of the shares at the time received totalled $82,600.[3]

In the spring of 1966, Sennott, who apparently had been oblivious to the waving banners of suspect practices of which he was the victim, learned that another member of the Board of Trade had filed a $75,000 claim against Jordan Rothbart with the Board of Directors alleging a fraudulent scheme remarkably similar to the circumstances of Sennott's own transactions with Jordan. At approximately the same time, Sennott also learned that Jordan Rothbart had previously been expelled from the securities market. Until that time, Sennott had been unaware of Jordan's prior fraudulent practices or his dismissal from Rodman. In spite of these revelations, however, Sennott clung to the hope that the stock would be delivered, and, in an effort to facilitate that vain hope, when summoned before the Business Conduct Committee investigating Jordan Rothbart, he refused to cooperate or disclose his dealings. Indeed, not until May 1966, after numerous delivery dates had passed without receipt of further shares of stock, did Sennott go to William Rothbart to inquire about the stock options. Sennott described his meeting with William Rothbart at the Rodman office. "I let Bill know exactly what was going on as far as no delivery of the Sky-

3.

| Date | Number of Shares | Closing Price | Amounts Received by Sennott |
|---|---|---|---|
| 2/26/65 | 1,000 | $27.25 | $27,250.00 |
| 3/ 3/65 | 600 | 27.625 | 16,575.00 |
| 5/ 4/65 | 200 | 29.50 | 5,900.00 |
| 8/ 3/65 | 400 | 24.375 | 9,750.00 |
| 8/ 5/65 | 300 | 24.00 | 7,200.00 |
| 12/13/65 | 200 | 22.75 | 4,550.00 |
| 1/20/66 | 500 | 22.75 | 11,375.00 |
| | 3,200 | | $82,600.00 |

line Homes, that he [Jordan] was probably going to be expelled from the Chicago Board of Trade, at which time Bill Rothbart told me there was nothing he could do about it."

Jordan was expelled from the Board of Trade in June 1966 for refusing to turn his financial records over to the Business Conduct Committee. At that point he ceased coming to the floor of the Board of Trade and Sennott discontinued his unsuccessful efforts to procure delivery of the stock by telephone. Only after all else had failed did Sennott approach Rodman with evidence of the scheme.

At the conclusion of a bench trial on the merits, the trial judge found Rodman vicariously liable for the losses caused the Sennotts. Liability was based upon several theories set forth in the court's conclusions of law. First, the court concluded that William Rothbart "knowingly assisted and participated in the efforts of Jordan Rothbart to defraud plaintiffs," in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 adopted by the Securities and Exchange Commission thereunder, Section 9(a)(4) of the Securities Exchange Act of 1934, and Section 17(a) of the Securities Act of 1933. The court then held that not only William Rothbart's knowledge of the solicitation of stock business by Jordan at the Board of Trade but also his knowledge of the false representations to Sennott regarding Skyline was acquired within the scope of the Rodman partnership business and therefore was imputed to and binding upon Rodman. In addition, the judge concluded that because Rodman "knew or should have known" of the illegal conduct of William and Jordan Rothbart, it was equally liable with them for the false representations. The trial judge also held Rodman accountable for Jordan Rothbart's action because it "aided and abetted" in the fraud in that, in breach of its broker-agent fiduciary duty, it failed to inform Sennott of Jordan's background. Finally, the trial court imposed liability on Rodman on the ground that Rodman failed to act in good faith with respect to its duties as a "controlling person" over William and Jordan Rothbart, Section 20(a) of the 1934 Act, 15 U. S. C. § 78t(a).

The ground rules for our review are well established and need not be repeated here. The applicable standards are collected and summarized by Judge Hastings in *Prince* v. *Packer Manufacturing Company*, 419 F. 2d 34, 36-37 (7th Cir. 1969). Assigning the matter of credibility to the district court we turn therefore to a determination of whether there is substantial evidence to support the findings of fact and whether the court erred as to the applicable law.

Taking the agency questions first, it is clear that Rodman must be deemed to have had knowledge of all of the securities transactions which Jordan solicited for his father prior to the inception of the fraudulent stock option scheme. In that situation, the knowledge of William Rothbart is, under general principles of agency, imputed to the partnership. Had plaintiff been defrauded in one of those transactions, Rodman's liability would seem to be unquestionable. Those transactions, however, do not comprise the substance of this lawsuit. On the contrary, the facts upon which liability must be established in this case, if at all, are critically different. While the evidence leaves no doubt that William Rothbart, having processed the orders and his firm having received a broker's fee, had knowledge of the solicitations of Jordan in the prior transactions, the record is silent as to a basis upon which the district court could properly have inferred that William had knowledge at any pertinent time of his son's stock option deception.

We are at a loss as to the basis in the record for the district court's conclusion that William Rothbart "knowingly assisted and participated" in the fraud. Indeed, the first contact the plaintiff had with William respecting the options took place in November 1964, after all of the payments for the stock had been made. This is not a pertinent time. There is no evidence that prior to the Carroll meeting William Rothbart did anything to induce Sennott to subject himself to Jordan's defalcations, nor that he had any knowledge of what was transpiring until after the fact.

Further, we find no reason to believe that Sennott considered William Rothbart to be any part of the transaction other than that he had been the original offeree of the mythical options. In fact, Sennott himself indicated that his understanding of Jordan's stricture of confidentiality to be he should not say a word about the transaction to anybody including William Rothbart. Sennott also testified that it was never his understanding that the option shares were coming from or through Rodman but he imagined they would be coming from the Skyline corporation itself. Finally, Sennott admitted on cross-examination that he had testified in his deposition that when asked by investigators for the Illinois Securities Commission, which was looking into his complaint against Jordan, whether William Rothbart had ever participated or conspired with Jordan to perpetrate the option fraud, he had replied, "[N]o, not to my knowledge."[4]

Citing *Crittendon* v. *State Oil Company*, 78 Ill. App. 2d 112, 115, 222 N. E. 2d 561, 563-564 (1966), Sennott contends on this appeal that Rodman & Renshaw is estopped by its conduct from claiming that Jordan was not its representative. Again, we do not disagree as to the transactions handled through that firm, but those are not the ones with which we are now concerned. Sennott also speaks of "apparent agency" established by Rodman. Without becoming involved in the semantic niceties of dis-

4. This would seem consistent with Sennott's description of his May 1966 meeting with William Rothbart at which he "let Bill know exactly what was going on as far as no delivery of the Skyline Homes. . . ." When questioned about that meeting, Sennott stated in deposition:

> "And at this particular time is when I said, 'Well, you know, Bill, whether you realize it or not, it was supposedly offered to you and that because you were a senior partner in Rodman & Renshaw, Jordie told me, under the SEC rules you couldn't accept it.'
>
> "He said, 'Well, that's not true.' He said, 'I knew nothing of the stock options in Skyline.'
>
> "And again I asked him, 'Why did you tell me before going to Carroll's office not to worry? I'd get my stock options in Skyline.'
>
> "He said, 'Because Jordie had assured me that you would.' "

tinctions, if any, between ostensible agency, apparent agency, and agency by estoppel, we note that *Crittendon* (78 Ill. App. 2d at 116) states that "[i]t is essential to the application of the doctrine of estoppel that such conduct or representations be relied and acted upon. . . ."

Under Sennott's theory of apparent authority or estoppel, therefore, plaintiff would be required to prove that he was relying upon Jordan's apparent authority, and hence on Rodman, when he decided to purchase the Skyline options. Reliance is not evident from the record before us. Indeed, the converse is clearly demonstrated, for not only did the fraudulent representations never involve Rodman but both Sennott and Jordan Rothbart actively sought to prevent Rodman from discovering the option transactions. Sennott agreed to keep the option plan secret, including from Rodman, and intentionally used personal payment receipts to record Sennott's payments. The strongest evidence of the plaintiffs' lack of reliance upon Rodman, however, is seen in Sennott's refusal to cooperate with Carroll's inquiry into the endorsements on Sennott's checks. Had Sennott been relying on Rodman's participation in the option plan, it is unlikely that he would have refused even to discuss the matter with a representative of Rodman. On the contrary, Sennott's own statements belie such reliance. Responding to an inquiry by defendant's attorney, Sennott observed, "[W]ith regard to this money that had been invested, I really felt that this thing would have completely gone undetected by Rodman & Renshaw had not that check been made out of the profit sharing."

The Sennotts also place considerable reliance on *Blackburn* v. *Dean Witter*, 19 Cal. Rptr. 842 (5th Dist. Ct. App. 1962), a case which they assert is "squarely in point." There, a registered representative of the defendant brokerage house persuaded the plaintiff to invest in stock of a nonexistent company. The plaintiff then, as Sennott did here, sold some stock through the brokerage house to finance the purchase of the nonexistent stock. The brokerage house was subsequently found liable for the

fraudulent acts of its representative. While *Blackburn* is factually similar to this case, a major distinction exists. The plaintiff in the *Blackburn* case was a customer who believed that he was purchasing stock through the brokerage house in the same manner as he had previously made purchases, and, as such, was relying on the expertise and integrity of the brokerage. Both the agency and the reliance elements were unquestionably present. Here, however, while some type of implied agency may well have existed as to other transactions, there was no reliance upon this agency in the transactions in question. Simply stated, the damage Jordan Rothbart inflicted upon the plaintiffs was a result of Sennott's misplaced reliance upon Jordan Rothbart and not upon Rodman & Renshaw.

Having reviewed the record at length and found that the evidence supports neither plaintiffs' theory that William Rothbart had knowledge of his son's reprehensible scheme which was imputable to Rodman nor their theory of apparent authority, we are forced to reject the trial court's factual findings and legal conclusions with respect to these issues.

Our findings on these issues are also dispositive of plaintiffs' other theories of liability. As to their position that Rodman was guilty of "aiding and abetting" in the option scheme, our conclusion that the evidence does not support the trial judge's finding that William Rothbart had knowledge of the fraudulent scheme precludes imposition of liability on this basis. Without a showing that a Rodman partner or agent had knowledge of the fraudulent acts, and in the absence of a showing that here Jordan was purporting to act for Rodman, there is no basis for holding Rodman liable for acts of third parties.

Similarly, plaintiffs' theory and the trial court's finding that Rodman is liable under Section 20(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78t(a) as a "controlling person" over William and Jordan Rothbart is without merit. The trial judge found that Rodman was in a position to control both men and that the partnership "did not act in good faith in exercising such

control." That finding, while sufficient to impose liability on Rodman for any of the pre-option scheme stock solicitations in which Sennott actually relied upon Rodman's involvement in deciding whether to act, is not an adequate foundation upon which to base liability where Rodman was admittedly not considered to be involved in the transaction. Rodman's duty to control its partners and agents, as well as its past employees, in situations such as this extends only to transactions with or by these parties where Rodman is itself involved. To extend it further would be to impose liability upon Rodman for virtually any act of its past or present employees and partners regardless of how remote and unrelated that act might be to Rodman & Renshaw. We are not inclined to read Section 78t so expansively.[5]

For these reasons the judgment below is reversed as to Rodman & Renshaw, and the cause is remanded with instructions to dismiss the complaint as to Rodman & Renshaw and to enter judgment for said defendant.

REVERSED AND REMANDED

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5. In addition, Section 78t governing the liabilities of "controlling persons" provides in part:

> "(a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

Liability is not imposed where the controlling person exercises good faith or does not induce the act which gives rise to the cause of action. Here, Rodman may not have acted in good faith with respect to the legitimate stock solicitation by Jordan Rothbart of which William Rothbart had knowledge, but Rodman's lack of knowledge of the fraudulent stock option scheme creates an entirely different situation. We do not see how Rodman can be found to have exercised bad faith with respect to a transaction of which it had no knowledge. It is equally clear that Rodman did not "induce" the acts of Jordan Rothbart, and without bad faith or inducement there can be no liability under this section.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

March 28, 1973

Before

Hon. LUTHER M. SWYGERT, *Chief Judge*
ROGER J. KILEY, *Circuit Judge*
Hon. THOMAS E. FAIRCHILD, *Circuit Judge*
WALTER J. CUMMINGS, *Circuit Judge*
Hon. WILBUR F. PELL, JR., *Circuit Judge*
JOHN PAUL STEVENS, *Circuit Judge**
ROBERT A. SPRECHER, *Circuit Judge**

RICHARD J. SENNOTT and JOAN SENNOTT, *Plaintiff-Appellees,*

No. 71-1201 *vs.*

RODMAN AND RENSHAW, *Defendant-Appellant.*

Appeal from the United States District Court of Illinois, Eastern Division.

No. 67 C 424
ALEXANDER J. NAPOLI, *Judge.*

On consideration of the petition of plaintiff-appellees Richard J. Sennott and Joan Sennott for a rehearing by the court *en banc* in the above-entitled appeal and the answer filed by counsel for defendant-appellant Rodman & Renshaw thereto, and the judges in regular active service having voted on the suggestion for an *en banc* rehearing,

* Judges Stevens and Sprecher voted to grant the petition.

IT IS ORDERED that the petition of plaintiff-appellees for a rehearing *en banc* in the above entitled appeal be, and the same is hereby denied.

## RELEVANT STATUTES, RULES AND REGULATIONS

### I. FEDERAL STATUTES.

15 U. S. C.

§ 771. Civil liabilities arising in connection with prospectuses and communications.

Any person who—

* * * * *

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (a) of subsection (2) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security. May 27, 1933, c. 38, Title I, § 12, 48 Stat. 84; Aug. 10, 1954, c. 667, Title I, § 9, 68 Stat. 686.

§ 77q. Fraudulent interstate transactions.

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of trans-

portation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 77c of this title shall not apply to the provisions of this section. May 27, 1933, c. 38, Title I, § 17, 48 Stat. 84; Aug. 10, 1954, c. 667, Title I, § 10, 68 Stat. 686.

§ 78i. Manipulation of security prices.

(a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exhange—

* * * * *

(4) If a dealer or broker, or other person selling or offering of sale or purchasing or offering to purchase the security, to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

* * * * *

June 6, 1934, c. 404, § 9, 48 Stat. 889.

§ 78j. Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. June 6, 1934, c. 404, § 10, 48 Stat. 891.

§ 78t. Liabilities of controlling persons.

(a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

(b) It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for

such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person.

* * * * *

June 6, 1934, c. 404, § 20, 48 Stat. 899; May 27, 1936, c. 462, § 6, 49 Stat. 1379; Aug. 20, 1964, Pub. L. 88-467, § 9, 78 Stat. 579.

* * * * *

## II. Federal Rules and Regulations.

Rule 10b-5. Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

(1) to employ any device, scheme, or artifice to defraud.

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.